DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200221052

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

SIN - 4945.04-04
NO THIRD PARTY CONTACTS

Date: FEB 26 2002

Contact Person:

Identification Number:

Contact Number:
Fax:

T:EO:B3

Employer Identification Number:

Legend:

A =
M =
P =
T =
X =
Y =

Dear Applicant:

This refers to your ruling request dated October 24, 2001, supplemented by your letter dated January 17, 2001, under sections 501(c)(3), 509(a), and 4940 through 4946 of the Internal Revenue Code (the Code).

X is exempt under section 501(c)(3) of the Code. X is classified as a private foundation under section 509(a).

X was initially funded by a gift from A. X receives substantially all of its income from Y, a trust created under the Will of A. The distribution from Y, along with the earnings of its investment portfolio, constitutes X's principal source of revenue.

X currently operates several grant programs that, under section 4945(h) of the Code, require expenditure responsibility agreement. X makes grants to other tax-exempt organizations, focusing on eight areas vital to growth in P's rural communities: community leadership; economic opportunity; life-long learning; environmental stewardship; infrastructure and services; recreational and cultural opportunities; diversity; and safety and security.

X continues to strive to find ways to support its mission of strengthening and improving rural communities in P. To this end, X proposes to initiate a new leadership initiative focusing on social entrepreneurship called M. M will support individual community members who have specific ideas on how to fulfill a significant unmet community need, take advantage of opportunities to improve their community, and fulfill a charitable purpose.

In the pilot phase of M, X will award up to 25 individuals (the Participants) up to $10,000 per year for a two-year commitment, to a maximum of $20,000. It is possible that this amount could be increased as the program evolves. The program is available to anyone throughout rural P on a non-discriminatory basis.

Participants may use the grant for a variety of charitable purposes designed to improve the recipient's rural community. Participants may use grant funds for meeting expenses, office supplies, professional advice and limited travel and training, all of which must be directly related to the specific purpose of the program they propose. However, Participants may not use the grants for personal gain, wages or salary supplementation, or obtaining an academic degree.

To be accepted, applicants must demonstrate that their projects would fulfill an identified community need or opportunity, have the potential to continue beyond the initial two-year time commitment, and seek to use innovative and creative approaches. Approved projects will be non-sectarian, non-denominational, and non-political, and will not be used to generate profit. Before X will disburse any grant funds, recipients will enter into an agreement with X that sets forth budget expectations, project work plans, and the parties' responsibilities.

There will be a written agreement between X and the Participant setting forth objectives and responsibilities. Participants will be required to establish a separate accounting system to account for the use of the funds, and submit annual financial statements to X. Participants will also furnish X with periodic reports on the use of the grant funds and an explanation of how the recipient has achieved the goals for which the grant was made. X will review and assess each Participant's progress after the first year.

An advisory committee will be established consisting of X's staff and others with expertise in leadership development and social entrepreneurship. The advisory committee will meet approximately semi-annually to monitor the program and suggest changes to improve its effectiveness.

Section 501(c)(3) of the Code exempts from federal income tax organizations that are organized and operated exclusively for exempt purposes, provided no part of its net earnings inure to the benefit of any private shareholder or individual.

Section 4940(a) of the Code imposes on a private foundation with respect to the carrying on of its activities, a tax equal to 2% of its net investment income for the taxable year.

Section 4941(a) of the Code imposes a tax on acts of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1) of the Code provides that the term "self-dealing" includes any direct or indirect-

> (D) payment of compensation (or payment or a reimbursement of expenses) by a private foundation to a disqualified person; and
>
> (E) transfer to, or use by or for the benefit of, a disqualified person of the income

or assets of a private foundation.

Section 4942(g)(1)(A) of the Code provides that the term "qualifying distribution" means to include any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3).

Section 4944(a) of the Code provides generally for the imposition of a tax on a private foundation and a foundation manager if investments are made in such a manner as to jeopardize the carrying out of the foundation's exempt purposes.

Section 4945(a) of the Code imposes a tax on each "taxable expenditure" of a private foundation as defined in section 4945(d).

Section 4945(d)(3) of the Code defines the term "taxable expenditure" as including an amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual, unless the grant satisfies the requirements of subsection (g),

Section 4945(g)(3) of the Code provides that subsection (d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary.

Section 4945(h) of the Code provides the taxable responsibility requirements that must be met for grants made to organizations described in section 4945(d)(4)(B).

Section 53.4945-4(c)(1) of the Foundation and Similar Taxes Regulations provides that grants to individuals must be made pursuant to a procedure approved in advance. To secure such approval, a private foundation must demonstrate to the satisfaction of the Commissioner that--

(i) Its grant procedure includes an objective and nondiscriminatory selection process;

(ii) Such procedure is reasonably calculated to result in performance by grantees of the activities that the grants are intended to finance; and

(iii) The foundation plans to obtain reports to determine whether the grantees have performed the activities that the grants are intended to finance.

No single procedure or set of procedures is required. Procedures may vary depending upon such factors as the size of the foundation, the amount and purpose of the grants and whether one or more recipients are involved.

Section 53.4945-6(b)(2) of the regulations provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination of whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

Section 4946(a) of the Code defines the term "disqualified persons" to include, with respect to a private foundation, a substantial foundation contributor, a foundation manager, an owner of more than 20% of the total combined voting power of a corporation, the profits interest of a partnership, or the beneficial interest of a trust of an unincorporated enterprise that is a substantial foundation contributor, or a family member of a substantial contributor, manager or owner.

We have considered the organization's grant making procedures under section 4945(g) of the Code. Based on the information submitted and assuming the program will be conducted as proposed, with a view to providing objectivity and nondiscrimination in awarding grants, we have determined that the procedures comply with the requirements of section 4945(g)(3), and that amounts granted according to these procedures will not be "taxable expenditures" within the meaning of section 4945(d)(3). We have not considered whether grants made under the procedures are excludable from the gross income of recipients.

This ruling is conditioned on the understanding that there will be no material change in the facts upon which it is based. It is further conditioned on the premise that no grants will be awarded to the organization's creators, officers, directors, trustees, or members of the selection committee, or for a purpose that is inconsistent with the purposes described in section 170(c)(2)(B).

The approval of the grant making procedures is a one-time approval of the organization's system of standards and procedures for selecting recipients of grants that meet the requirements of section 4945(g)(3) of the Code. Thus, approval will apply to succeeding grant programs only as long as the standards and procedures under which they are conducted do not differ materially from those described in the request. Since these are grants meeting the requirements of section 4945(g)(3), they are not subject to the expenditure responsibility requirements of section 4945(h).

Furthermore, as described above we find that the proposed grants do not involve disqualified persons to be considered as acts of self-dealing under section 4941 of the Code. Since the grants will be given to applicants for the charitable purpose of improving the rural communities of P, they will be qualifying distributions within the meaning of section 4942(g)(1)(A). Also, the proposed grants do not constitute investments that would be considered jeopardizing investments under section 4944 or give rise to taxes on investment income under section 4940. Moreover, we find that the activities in connection with the proposed grants will not confer private benefits that would adversely affect the exempt status of X under section 501(c)(3) or its classification as a private foundation under section 509(a).

Based on the foregoing and as requested, we rule as follows:

1. That the (a) proposed grants to individuals and (b) the payment of the legal, accounting and other expenses (including filing) incurred by X in connection with this ruling request will not constitute a taxable expenditure under section 4945 of the Code and no expenditure responsibility will be imposed under section 4945(h);

2. That the proposed grants to individuals will not be an act of self-dealing within the meaning of section 4941 of the Code and therefore will not result in the imposition of additional tax under that section;

3. That the proposed grants to individuals will not give rise to net investment income and will therefore not result in the imposition of any excise tax on net investment income under section 4940 of the Code;

4. That the proposed grants to individuals will constitute qualifying distributions within the meaning of section 4942 of the Code and will not subject X to any excise tax under that section;

5. That the proposed grants to individuals will not constitute an investment on the part of X, and therefore X will not be subject to the tax on jeopardizing investments within the meaning of section 4944 of the Code; and

6. That the proposed grants to individuals will not jeopardize the tax-exempt of X under section 501(c)(3) of the Code and private foundation classification under 509(a).

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Please keep this in your permanent records.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Robert C Harper, Jr.

Robert C.Harper, Jr.
Manager, Exempt Organizations
Technical Group 3